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C O N F I D E N T I A L RIGA 000723

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TAGS: EFIN PGOV ECON IMF LG
SUBJECT: (C/NF) IMF PUSHING FOR FULL NATIONALIZATION OF
PAREX

REF: A) RIGA 690 B) RIGA 701 C) RIGA 714

Classified By: Ambassador Charles W. Larson. Reason: 1.4 (b and d)

¶1. (C/NF) Summary: The IMF appears to be making the full nationalization of Parex bank a condition for assistance to Latvia. The Fund argues that the current situation is not working and leaves the previous owners too much authority -- and leaves open the possibility of asset stripping. Implicit in the fund's argument is that politics has played too big a role in the current deal. An IMF requirement for full nationalization of Parex might be enough political top-cover for the government to take the decision. End summary.

¶2. (C/NF) Irena Krumane (strictly protect), head of Latvia's regulatory agency the FCMC, provided the Ambassador a copy of a November 22 paper from the IMF assessment team in Latvia arguing for a full nationalization of Parex bank (refs a and c provide background). Krumane repeatedly stressed the sensitive nature of this information.

¶3. (C/NF) In the paper, the fund says the current plan of 51% state ownership "is clearly not working" and adds that leaving the current owners in control of the institution creates a situation "ripe for asset stripping or worse." The fund states that as of November 19 the government had nearly LVL 750 million (roughly USD 1.36 billion) in exposure through treasury deposits and Bank of Latvia loans to Parex. That was before any thought of an injection of up to LVL 200 million in capital to the bank or the government guarantee of around Euro 775 million in syndicated loans due in the first half of 2009. The paper also notes that "some off balance items may appear and could be significant" and that "the current owners may have engaged in unbooked or strange transactions during the current interregnum."

¶4. (C/NF) The fund further argues that full nationalization allows the state to fully control the operation of the bank, through the installation of "credible and competent new management." It suggests that the announcement could be made in conjunction with the announcement of an international assistance package to stem deposit outflow. The fund is hopeful that current owners would be amenable to selling to the government, but if not, discusses ways that Latvia could nationalize the bank through legislation (which would, as an emergency measure, require a 2/3 vote in Saeima

¶5. (C/NF) Nationalization, according to the fund, would make the bank more attractive to potential investors after recapitalization and restructuring by the government. The paper acknowledges the current global situation may make finding a buyer harder and says that the EBRD "has tentatively indicated that it might consider taking an equity stake and assist the authorities in looking for a strategic investor."

¶6. (C/NF) If nationalization cannot be completed quickly (within two weeks), the IMF says the government should

consider a deposit freeze, but highlights the likely harmful effect on other banks and the lasting damage to public confidence in the banking sector overall. The fund rejects any notion of revoking Parex's license as too costly and also rejects a purchase and assumption agreement ("good bank/bad bank transaction") as too slow and difficult to implement.

¶7. (C/NF) Comment: The IMF appears to share the concerns we noted ref b about the possible politicization of the original deal and barely masks its contempt for an arrangement that leaves the two previous owners with any role in the bank's management and administration. We don't yet know what the government reaction to this proposal is, but we think they could accept it as an IMF mandate, especially if they can avoid devaluation as part of the assistance deal. But even if the government does fully nationalize the bank, it will then need to ensure the "credible and competent new management" the fund insists is essential to the success of any plan.
LARSON